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In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 537

A. ATWATER KENT, PETITIONER

v.

WALTER J. ROTHENSIES, COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the United States District Court for the Eastern District of Pennsylvania (R. 3–11) is reported in 35 F. Supp. 291. The opinion of the Circuit Court of Appeals (R. 92–98) is reported in 120 F. (2d) 476.

JURISDICTION

The judgment of the court below was entered May 22, 1941 (R. 99). The petition for a writ of certiorari was filed August 22, 1941. The jurisdic-

tion of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The petitioner created three trusts to pay specified amounts of income therefrom to each of his three children and to accumulate the remaining income for a period of two years to be distributed to him at that time, if living. The petitioner retained substantial control over the management of the trusts and the excess amounts accumulated for distribution to him were considerably in excess of the amounts paid to the children. Is petitioner taxable upon such accumulated income during the year it was earned under either Section 22 or Section 167 of the Revenue Acts of 1932 and 1934?

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra,* pp. 8–10.

STATEMENT

The facts as stipulated by the parties (R. 13–85) may be summarized as follows:

On May 20, 1932, petitioner executed three trusts in the names of his three children, Elizabeth Kent Van Alen, Virginia Tucker Kent, and A. Atwater Kent, Jr. (R. 13–14, 21–58). Petitioner and a trust company were trustees of each of the trusts. (R. 13–14.)

Petitioner transferred to each of these trusts some 28,762 shares of preferred dividend stock in Atwater Kent Manufacturing Company. Each trust was to continue until the death of the survivor of the grantor's wife and the child whose name the particular trust bore (R. 25, 37, 49).

Under Section I of each of the trust instruments, it was provided that after payment of certain specified amounts from the year's income from the trust property to the child indentified with the trust, here, the balance of the income should be accumulated and held by the trustees for a period of two years, at the end of which time it was to be distributed to petitioner, if living, on the date named for distribution (R. 23, 35–36, 48). The dates of distribution were designated as the June 30 and the December 31 following the expiration of the two years after the income was earned (R. 23, 35, 47–48). If the grantor were not living on the payment dates the accumulated income was to go to named beneficiaries who were members of the petitioner's family (R. 24–25, 36–37, 49–50). After the grantor's death, the practice of accumulating income was to be discontinued and all of the income, except the amounts paid to the child whose name the trust bore, was to be currently distributed to petitioner's wife or the other named beneficiaries (R. 24, 37, 49).

The payments of current income to be made to the named child under each trust were shown by

schedules attached to each of the trust instruments. No payments were to be made to Virginia Tucker Kent or A. Atwater Kent, Jr., during any of the years here involved (R. 44–45, 57). Payments to Elizabeth Kent Van Alen were to begin in 1933, in which year she was to receive $10,000, which amount was to be increased by $5,000 in each of the succeeding years until the annual payment reached $75,000 (R. 32).

In addition to the current payments to the children out of the income, the trustees were authorized on each June 30 and December 31 to use not in excess of $5,000 of the accumulations being held to that date as might be necessary to bring the current payments for the last preceding calendar year up to the maximum amount payable to the child under the schedule contained in each of the trust instruments (R. 23, 35, 47–48).

During the years 1932–1934, each of the three trusts had income greatly in excess of the payments, if any, required to be made to the named beneficiaries other than the grantor (R. 14–15). Pursuant to the terms of the trust instruments the income, less the current payments to Elizabeth Kent Van Alen in 1933 and 1934, was accumulated and held by the trustees for two years following its receipt. At the end of the two years these amounts, reduced only by disbursements for income taxes and minor items, were, on the dates designated for distribution, paid to petitioner (R. 15–16).

Each of the trust instruments provided that none of the stock of the Atwater Kent Manufacturing Company or of any other corporation in which the petitioner held the majority of stock could be sold by the trustees without the grantor's consent (R. 26–27, 39, 51–52). The trust instruments further provided that the trustees could lend money with or without security to the Atwater Kent Manufacturing Company or other Atwater Kent company, or any successor thereof and should not be held accountable for loss on account of such loans (R. 28, 40, 52).

In his income tax returns for the years 1932–1934, inclusive, petitioner did not include in his income any part of the amount accumulated under the three trusts (R. 16–17). The Commissioner of Internal Revenue assessed deficiencies against petitioner based on the inclusion in his income for each of the three years of the amounts accumulated in the trusts. Petitioner paid the deficiencies and brought suit for refund. The District Court held that the accumulated income was not taxable to petitioner (R. 2–12), but the Circuit Court of Appeals reversed the judgment of the District Court (R. 92–99).

ARGUMENT

The court below correctly held that the accumulated income was taxable to the grantor under Sec-

tion 167 (a) (1) of the Revenue Acts of 1932 and 1934, which provides:[1]

> SEC. 167. INCOME FOR BENEFIT OF GRANTOR.
>
> (a) Where any part of the income of a trust—
>
> (1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor;
>
> * * * * *
>
> then such part of the income of the trust shall be included in computing the net income of the grantor.

The fact that the happening of a contingency (such as the death of the grantor before the period of distribution) may prevent him from receiving the accumulated income does not change the operation of Section 167 (a) (1). At least three other circuit courts of appeals have so ruled in situations where the contingencies were in fact greater and the periods of accumulation much longer. *Kaplan* v. *Commissioner,* 66 F. (2d) 401 (C. C. A. 1st); *Altmaier* v. *Commissioner,* 116 F. (2d) 162

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[1] The Government also contended below that the taxpayer was chargeable with the income in controversy under Section 22 (a). In holding the income taxable under Section 167 (a) (1) the court below found it unnecessary to pass upon the applicability of Section 22 (a). If the petition is granted, however, we intend to renew our contention that both Section 22 (a) and Section 167 (a) (1) support the tax.

(C. C. A. 6th), certiorari denied, 312 U. S. 706; *Graff* v. *Commissioner,* 117 F. (2d) 247 (C. C. A. 7th).

There are no decisions of any circuit court of appeals to the contrary. *Commissioner* v. *Dean,* 102 F. (2d) 699 (C. C. A. 10th), relied upon by petitioner, is not in conflict with the decision below. The question in the *Dean* case was whether certain income was taxable to the beneficiary of a trust under Section 162 (b) of the Revenue Act of 1928 where, under the terms of the trust, it was not to be distributed to him until the succeeding year. But under Section 162 (b) a beneficiary is taxable only upon income "which is to be distributed currently by the fiduciary." The provisions here involved, on the other hand, were expressly designed to render the grantor liable with respect to income that is not currently distributable.

CONCLUSION

The petition should be denied.

Respectfully submitted.

CHARLES FAHY,
Acting Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
ARNOLD RAUM,
J. LOUIS MONARCH,
HUBERT L. WILL,
Special Assistants to the Attorney General.

SEPTEMBER 1941.